**Priority: Buyers v. Secured Parties**

Welcome to this podcast on Priority: Buyers v. Secured Parties brought to you by CALI. I am Professor Jennifer S. Martin. The topic of this podcast is which party will prevail in a competition for collateral as between buyers of the collateral and secured parties. While secured parties might expect to prevail with respect to their collateral most of the time, buyers of goods also have expectations that are protected with respect to their purchases. Sometimes we expect buyers to search the records before purchasing, but not always. The rules of Article 9 balance expectations so that buyers get good title to what they buy and have protection from pre-existing security interests in some circumstances. These rules are commonly tested on law school and bar examinations so pay close attention.

Recall that a debtor sometimes sells collateral even where the security agreement states otherwise. However, the rule of § 9-315 provides that a security interest continues in collateral notwithstanding sale or disposition, so buyers of goods purchase subject to a prior security interest, unless an exception applies. As it turns out, there are four primary exceptions concerning buyers: (i) the buyer in ordinary course exception of § 9-320(a); (ii) the consumer to consumer sale exception of § 9-320(b); (iii) the authorized sale exception of § 9-315; and (iv) the failure to perfect exception of §§ 9-317 and 323.

Let’s begin with the buyer in ordinary course exception of § 9-320(a). Buyers who purchase goods from a seller in the ordinary course of the seller’s business do not have to search the records before purchasing in order to be protected from the claims of even a perfected secured party as to the collateral, even if the buyer knows of the security interest. Such buyers in the ordinary course of business take free of a security interest created by the *buyer’s seller*.

But let’s break this down to make sure we understand how the rule works. First, notice that we are only applying this rule with respect to goods. Second, the buyer must be a buyer in the ordinary course, which is defined in U.C.C. § 1-201 as a person who buys in good faith, without knowledge that the sale violates the rights of another person in the goods, in the ordinary course from that person, and the purchase is from a party in the business of selling goods of that kind. The person selling the goods cannot be a pawnbroker. The purchase can be for cash, exchange of other property, or even on secured or unsecured credit. It is usually a purchase from inventory of the seller though.

Let’s look at a straightforward example. Music City is in the business of selling musical instruments to consumers. First Bank finances the inventory of Music City, taking a security interest in the inventory and properly filing a financing statement listing the inventory as collateral. Music City purchases trombones, trumpets, flutes, and clarinets from Supplier. I need a clarinet for my young son Marshall and purchase one for $500 from Music City.

Under the rule of § 9-315, the security interest of First Bank continues to be attached to the clarinet I purchase unless an exception applies. However, we don’t normally expect consumers to search the public records prior to purchasing ordinary goods such as clarinets. Accordingly, the rule of § 9-320 applies here. First, a clarinet is goods. Second, I am a buyer in the ordinary course. When Music City sells musical instruments, such sales are most likely to be in the ordinary course of the business of Music City, which is in the business of selling musical instruments. There is nothing unusual about the sale, and I’m a buyer in the ordinary course of Music City’s business. I would take free of a security interest created by my seller, Music City. Meaning, I would take free of the security interest of First Bank.

But, there are less common situations that occasionally appear on examinations: (i) pawnbrokers, (ii) those not in the ordinary course, and (iii) security interests created by other parties. An example of each will show how the rule applicable to buyers in the ordinary course do not protect all buyers.

First, pawnbrokers. Suppose First Bank takes a security interest in the inventory of Pawnbroker and properly files a financing statement listing the inventory as collateral. Pawnbroker sells me the clarinet for Marshall. I will not take free of the security interest of First Bank, because I am not a buyer in the ordinary course. I cannot be a buyer in the ordinary course when I purchase from a pawnbroker.

Second, other types of sellers. Suppose instead that while Music City is in the business of selling instruments, if I make the same purchase of the clarinet from City Furniture, the buyer in the ordinary course exception would not protect my purchase if City Furniture is not in the ordinary course of selling musical instruments. I would have to hope that another exception protects my purchase or I will lose a contest with a perfected secured creditor.

Third, security interests created by other parties. Suppose that Supplier borrows money from Second Bank, granting it a security interest in its inventory. First Bank lends money to Music City for financing of its inventory. Both lenders file financing statements. If I purchase the clarinet from Music City as a buyer in the ordinary course, I would take free of the security interest of First Bank because it was created by my seller, Music City. I would not take free of the security interest of Second Bank because it was created by Supplier, who is not my seller.

Let’s turn to the consumer to consumer sale exception of § 9-320(b). This exception protects buyers of goods who purchase from a person who used the goods primarily for personal, family, or household purposes. The buyer will take free of the security interest, even if perfected if the buyer purchases without knowledge of the security interest; for value; primarily for the buyer’s personal, family, or household purposes; and before the filing of a financing statement covering the collateral.

Often this rule applies where a secured party relies on automatic perfection of a purchase money security interest in consumer goods and the debtor sells the goods in a consumer to consumer transaction. For instance, I purchase a used refrigerator for my home from Scott for $300 not knowing that when Scott acquired the refrigerator he granted a security interest to Sears and Sears relied on automatic perfection rather than filing. In this situation, I would take free of the security interest of Sears because I did not know of the security interest; I paid $300 for it and I purchased for personal, family or household purposes. Of course, if I purchased the refrigerator for my office, the purchase would not qualify for the consumer to consumer exception because the purchase is no longer for personal, family or household purposes. Furthermore, Sears could protect itself by filing a financing statement before my purchase.

Buyers which do not qualify for either of the first two exceptions are ordinarily expected to search the public records, but there are exceptions to this for: unperfected security interests, authorized dispositions and some future advances.

First, a buyer of most tangible and intangible collateral takes free of a security interest that is *not perfected* if the buyer gives value and receives delivery of the collateral (if we are dealing with tangible collateral) without knowledge of the security interest under the rule of § 9-317(b) and (d).

For instance, suppose I purchase a clarinet for Marshall from a professional musician, Sarah. Sarah’s instruments are subject to a security interest of Third Bank. The purchase would not comply with the buyer in the ordinary course exception because Sarah is not in the business of selling instruments. The purchase would also not comply with the consumer to consumer transaction because Sarah is not a consumer with respect to the instrument. However, if the security interest of Third Bank is not perfected, I would take free of the security interest.

Second, it is worth noting that sometimes collateral is sold as a disposition authorized by the secured party free of the security interest under § 9-315. For example, if Third Bank authorizes the sale of the clarinet by Sarah free of the security interest, then the security interest does not continue in the collateral and I purchase free of it. A lender might agree to this, for instance, if it has other collateral or Sarah is using the proceeds to pay down the loan obligation.

Finally, a buyer will even take free of the security interest securing some future advances if made after the secured party has knowledge of the buyers purchase, or 45 days after the purchase under the rule of § 9-323. Presume Third Bank has a future advance clause in its agreement with Sarah. Third Bank lends Sarah an additional $10,000 against her musical instruments, with knowledge that she has already sold the clarinet to me. My clarinet purchase would not be collateral for the $10,000 advance.

At this point, you should be able to identify and describe the exceptions that permit a buyer of collateral subject to a security interest to take free of the security interest and prevail over a secured creditor. You should also be able to apply the rules of common factual presentations concerning buyers.

I hope you’ve enjoyed this podcast on Priority: Buyers v. Secured Parties.

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